

OUR NEW LIMITED PARTNERSHIP ACT

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Ohio has had statutory provision for the formation of partnerships containing one or more partners with limited liability for over one hundred years.¹ The first such law in the United States was enacted by the legislature of the State of New York in 1822,² amended somewhat in 1829, and this latter version copied almost word for word by the Ohio Legislature in 1846.³ There has been practically no change in the Ohio law since its adoption, hence for all practical purposes, the formation and maintenance of the partnership, the liability of the partners to each other and to creditors, and the dissolution and winding up of the limited partnership in Ohio has been governed by legislation dating back to the days of canal construction.

Although the great majority of the states have already adopted the Uniform Limited Partnership Act,⁴ Ohio had neglected to modernize its law. No legislature prior to 1957 had ever become sufficiently aware of the inadequacy of the law to take positive steps to correct the situation. While the 1957 Act is not designated as the Uniform Limited Partnership Act, it differs only in minor particulars. The enactment was accomplished by amending §§1781.01 to 1781.17 and enacting §§1781.18 to 1781.27 of the Ohio Revised Code.⁵

Whether this new legislation is an improvement in the regulation of this form of business organization can be best shown by considering the needs and purposes of the limited partnership in conjunction with the question of whether the prior legislation encouraged their formation.

The limited partnership as a business entity generally serves two basic economic needs:⁶

- (1) The need by the owner, or owners, of business enterprises to secure more working capital, without incurring addi-

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¹ 44 Ohio Laws 29 (1846).

² "An Act Relative to Partnership," Laws of N.Y., 45th Session., Ch. CCXLIV p. 259 (1822). This was the first instance of the introduction of a statute into the United States that was not of British origin. 3 KENT, COMM. 36. "Limited partnerships were unknown to the common law and like corporations, are 'creatures of statute.'" *Rozicka v. Rager*, 305 N.Y. 191, 111 N.E. 2d 878 (1953).

³ *Supra* note 1; see 30 OHIO JUR., *Partnership* §181, p. 1188.

⁴ 8 U.L.A. '56 P.P. 6 indicates that 37 states have adopted the Uniform Limited Partnership Act.

⁵ Ohio Amended House Bill 74. OHIO REV. CODE §§1781.01 thru 1781.17 (Supp. 1957) are not analogous to previous provisions bearing the same OHIO REV. CODE section numbers.

⁶ "... permitting limited partnerships . . . intended to encourage investment in business enterprise by according to a limited partner a position analogous to that of a corporate shareholder." *Rozicka v. Rager*, *supra* note 2.

tional indebtedness and without sharing management control over the business.

- (2) The need for investment opportunities by the holders of available investment capital without assuming either risks in excess of the investment or the immediate responsibilities of management.

If legislation created a healthy climate in which these two needs could be satisfied, then it would encourage, or at least facilitate, the formation of such enterprises.⁷ If, on the other hand, legislation had a tendency to discourage the union of these two needs, it would not serve the purposes for which it was enacted and perhaps the state having such legislation would be as well without it.

It was the feeling of the Uniform State Laws Committee of the Ohio State Bar Association, which sponsored the new legislation and helped guide it to ultimate adoption, that the previous legislation—antiquated, ambiguous, and impractical—actually discouraged the formation of the very organizations it sought to encourage. The Committee felt that there was so much absurd and needless regulation on the organization and maintenance of the limited partnership and so many circumstances, a number of which were beyond the partner's control, that could result in the status of the limited partner changing suddenly to that of general partner, that no one properly informed would dare to become a limited partner.

THE AMBIGUOUS PROVISIONS OF THE OLD LAW

One of the circumstances which gave rise to a change of status and liability from limited to general partnership was any false statement made in the certificate,⁸ whether knowingly and intentionally false or only carelessly or mistakenly false, and regardless of whether the false statement would prejudice creditors.⁹

⁷ *White v. Eiseman*, 134 N.Y. 101, 31 N.E. 276 (1892). "The primary object of the Act authorizing limited partnerships was to encourage those having capital to become partners with those having skill by limiting the liability of the former to the amount actually contributed to the firm."

⁸ OHIO REV. CODE §1781.03 (1953); OHIO REV. CODE §1781.02 (1957). "(A) (1) Sign and swear to a certificate . . . (B) A limited partnership is formed if there has been substantial compliance in good faith with the requirements of division (A) of this section." Cf. 8 U.L.A. §2. "If . . . certificate . . . materially false, the statutory result was to make all liable as general partners. . . [I]t was considered hazardous for one to invest money in a partnership enterprise upon the faith of compliance with limited partnership statutes, which were quite commonly regarded as a trap to catch the unwary rather than a proper means to a desirable end. To relieve from such undue hazard, and make more safe to investors not participating in the business, the employment of their capital in partnership enterprises . . . the 'Uniform Limited Partnership Act' was drafted . . ." *In re Marcuse & Co.*, 281 Fed. 928 (7th Cir. 1922).

⁹ OHIO REV. CODE §1781.06 (1957). "If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false: (A) At the time he

A limited partnership was considered formed as soon as the certificate was made, acknowledged and recorded. The very next section, however, provided that if a copy of the certificate is not published in a newspaper of general circulation for six weeks in every county where the partnership does business, the partnership shall be deemed general.¹⁰

One can readily imagine a situation where a partner might have limited status immediately upon the signing, acknowledging and recording of the certificate and become a general partner due to some delay in the publication and then upon the completion of the advertising in a proper fashion be related back to limited status.

This publication provision was fraught with hidden dangers, because of the various interpretations that might be placed on its rather complicated wording.¹¹ For instance, what was meant by publishing for six weeks? Did it mean publishing every day for six weeks? Or perhaps once a week for six weeks? The word "immediately" is also open to question, and might be interpreted by different courts in different ways. Does "immediately" mean the same day as the recording, or within a reasonable time?

The old act also provided that upon every renewal of a limited partnership, or upon its continuance beyond its agreed duration, a new certificate must be made and the same procedure followed as was required with the original certificate. Every partnership not so renewed was deemed a general partnership.¹² If the partnership was continued for one day beyond its scheduled date without all these steps being taken, a general partner's liability attached to the former limited partner. Yet until the period is at an end, there is no way of knowing exactly how prosperous the enterprise has been and whether or not it is desired to continue the business, for another period, and if so, on what terms. Many types of limited partnerships, especially stock broker partnerships, are for a stated term of one year. This short period is fixed because the partners desire to reconsider frequently their relative contributions to capital, or admissions of new members. Yet it is essential that the business be conducted without interruption.

If we assume that a limited partnership is formed for one year ending December 31, 1957, and because of delay in getting signatures to a new agreement and certificate, or for any other reason, the new

signed the certificate; or (B) Subsequent to such signing, but within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate. . . ." Cf. 8 U.L.A. §6. See Annotation, Liability for False Information in Certificate of Limited Partnership, 34 A.L.R. 2d 1454.

¹⁰ OHIO REV. CODE §1781.04 (1953). The new code provisions have no publication requirement.

¹¹ See *Smith v. Argall*, 6 Hill 479 (N.Y. 1844), *aff'd* 3 Denio 435 (N.Y. 1846).

¹² OHIO REV. CODE §1781.06 (1953); OHIO REV. CODE §1781.24 (1957). Cf. 8 U.L.A. §24.

agreement and certificate is not recorded until after January 1, 1958, then the partnership would be deemed general. All the questions raised concerning the original advertising and qualification, are just as applicable to a renewal of partnership.

The old act also provided that every alteration in the names of the partners, the nature of the business, or any other matter specified in the original certificate, shall effect a dissolution of the partnership. Every such change caused the organization to be deemed a general partnership, unless renewed as a special partnership.¹³ It might have become a debatable question, which only litigation could settle, whether there had been an alteration "in the nature of the business." It might also have been a question that no two courts would interpret the same way.

Suppose that during the term of a partnership agreement one of the partners died, thereby effecting a dissolution of the partnership, and that partnership continued in business under the same name for a few days until a certificate of renewal could be drawn, signed, acknowledged and recorded. Under such circumstances the limited partnership became a general partnership from the moment of the death of the partner. The only alternative to this result would have been to close the office immediately upon a partner breathing his last. If the other partners knew about it, this they could do. If they did not know about it immediately, and it is unlikely that they would, then a general partnership would result from the time of the death of the partner to the time the business was closed down, or until a new certificate meeting all the requirements of the original certificate was filed.

The old act provided that the business of a limited partnership should be conducted under a firm name to which the names of all general partners are inserted, except that where there are two or more general partners, the firm name may consist of one or more of such partners, with the addition of "& Co." If a special partner permitted his name to be used in the firm name, he was deemed a general partner.¹⁴

Suppose a general partnership known as "Brown, Smith & Company." Assume that Mr. Smith died and Mr. Smith's son asked to become a limited partner. What were his duties with respect to the name "Smith" appearing in the partnership name? The name Smith may have been in the firm name long before the son was born and therefore could by no stretch of the imagination be intended to refer to the son. Yet it would have been very perilous to young Smith to permit the family name to be used in the firm name after the death of his father. In such

¹³ OHIO REV. CODE §1781.07 (1953); OHIO REV. CODE §1781.24 (1957).

¹⁴ OHIO REV. CODE §1781.08 (1953); OHIO REV. CODE §1781.05 (1957).

"The surname of a limited partner shall not appear in the partnership name, unless: (1) It is also the surname of a general partner; or, (2) prior to the time when the limited partner became such in good faith, the business had been carried on under a name in which his surname appeared." Cf. 8 U.L.A. §5.

case a creditor might have claimed successfully that the son became a general partner.

IMPRACTICAL PROVISIONS OF THE OLD LAW

The former law limited the purpose for which such partnerships may be formed to mercantile, manufacturing and mining.¹⁵ Needless to say, there is no logic, or reason in such a restriction. Such partnerships should be permitted to be formed for any purpose for which a general partnership may be formed.

The old law limited the contribution of the partner to cash.¹⁶ In a general partnership the contribution of the partner may be either in property or cash and there is no valid reason why the same rule should not apply to limited partnership.¹⁷ The old law required the name of at least one of the general partners to be in the firm name,¹⁸ a provision of dubious value. The old law required the names of the partners to be posted on the outside of the place of business.¹⁹ Here again we can search with diligence to find a practical value of this provision. The old law did not permit a limited partner to share in dividends or profits.²⁰

Under the old law a limited partner did not have the priority of a firm creditor on dissolution of the partnership.²¹ Irrespective therefore of his willingness to bail the organization out of financial difficulty by loaning it money, and irrespective of how necessary to the future success and welfare of the organization such help would be, he could not become a creditor.

THE PAST AND THE FUTURE

It is perfectly evident that the limited partnership form of business enterprise has not been popular in Ohio. This is shown in part by the

¹⁵ OHIO REV. CODE §1781.01 (1953); OHIO REV. CODE §1781.03 (1957). "A limited partnership may carry on any business which a partnership without limited partners may carry on, except banking and insurance." Cf. 8 U.L.A. §3.

¹⁶ OHIO REV. CODE §1781.02 (1953); OHIO REV. CODE §1781.04 (1957). "The contributions of a limited partner may be cash or other property, but not services." Cf. 8 U.L.A. §4.

¹⁷ OHIO REV. CODE §1775.07 (1953).

¹⁸ OHIO REV. CODE §1781.08 (1953). No comparable provision is in the current enactment. OHIO REV. CODE §1781.05 (1957) pertains to use of limited partner's name in contrast to the 1953 code requirement on use of general partner's names.

¹⁹ OHIO REV. CODE §1781.09 (1953). No comparable provision is in the current enactment.

²⁰ OHIO REV. CODE §1781.13 (1953); OHIO REV. CODE §1781.15 (1957). Cf. 8 U.L.A. §15.

²¹ OHIO REV. CODE §1781.14 (1953). In case of the insolvency of a limited partnership, no special partner may claim as a creditor of the partnership until the claims of all the other creditors of the partnership are satisfied. OHIO REV. CODE §1781.13 (1957). "A limited partner also may loan to and transact other business with the partnership, and, unless he is also a general partner, receive on account of resulting claims against the partnership, with general creditors a pro rata share of the assets. . . ." Cf. 8 U.L.A. §13.

dearth of Ohio court decisions. That lawyers generally seem to know little about it seems to indicate that they have never had any call to familiarize themselves with the applicable law. The lawyer who has been requested by a client to familiarize himself with its provisions could in good conscience advise his client that the safe course to follow was to stay out of limited partnerships altogether.

But with the new law, and the elimination of practically all the restrictions that discouraged the previous organization of such types of business enterprise, the question arises whether limited partnerships will become a more popular form of business organization.

While I do not choose to pose as a prophet, my feeling is that it will not. The partnership organization grew up in an era which involved less efficient communications, financing by local capital, and management limited to local well-known persons. While we were in that stage of economic development, the partnership filled the needs then outstanding.

The two basic economic needs mentioned earlier have for over one hundred years been met and served by the corporation. It is indeed unlikely, even under the new Limited Partnership Act, that any benefit could be accomplished with the use of a limited partnership that could not be obtained by the much more popular corporate form. Notwithstanding defects in the corporate entity, such organizations have proved very popular, and are widely used. It is unlikely that the corporate form will lose its popularity in the foreseeable future, although it is possible that some other type of business organization will appear with so many virtues that it will supplant the corporate form. When and if that happens, it will be something to which we can step up rather than back. In terms of safeguarding capital, providing continuity, and preserving some degree of stability and predictability to the businessman's rights and liabilities, the limited partnership is a step backward.